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Exporter Guide

Ukrainian Food Markets in 2004

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Report Highlights:

The Ukrainian retail and food processing sectors are developing quickly with potential to become significant regional suppliers especially to former Soviet countries. The trading environment is complicated and not transparent due to import duties, specific sanitary and veterinary regulations. The relationship between the government and business is often unofficial and nontransparent, so potential exporters are advised to secure an experienced Ukrainian partner who has established contacts and is able to navigate the myriad of obstacles facing imported agricultural products.

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SECTION I. MARKET OVERVIEW

Macroeconomic performance and other indicators

Over the past four years, Ukraine's macroeconomic indicators have been quite stable, creating a good environment for further economic expansion. Ukraine has achieved high rates of economic growth, stabilized the national currency (unofficially pegged to U.S. dollar at the rate of 5.32 UAH per 1 U.S. dollar), and sustained a gradual per capita income increase.

In 2003, GDP increased 8.2% and reached \$48.8 billion dollars. Per capital income reached \$1,020.00 dollars. In 2002, Ukraine recorded a 4.8% GDP growth rate and totaled \$41.5 billion dollars. Relatively high growth rates are a result of significant reforms that were implemented during the mid 1990's. For 2004, the GDP growth rate is expected to exceed 9%. Economic growth is being driven by strong domestic demand and growing world prices for key Ukrainian exports (metals, chemical products, heavy machinery and grains). Per capita income and consumption are on the rise, but still lower than the average in most developing countries. Ukraine possesses a sizable shadow economy that developed due to excessive tax pressure, nontransparent and frequently changing legislation, and lack of law and contract enforcement. Experts estimate the size of the parallel shadow economy to be between 50 and 60 percent of the legal one. Widespread corruption became a serious problem in late 1990's. The country is ranked 122 out of 145 on the Transparency International Corruption Perception Index scoring 2.2 (10 is the zero corruption level).

As of 2004, the population of Ukraine was estimated to be 48 million, making it the second largest consumer market in Central and Eastern Europe after Russia. The market is characterized by the increasing number of elderly and slowly decreasing population. The size of the official labor force increased by 1.7% in 2002 to 21.4 million compared with 21.0 million in 2001. In 2003, the official unemployment rate reached 3.6%, but experts point out that the actual number is higher due to unrecorded unemployment, especially in rural areas.

Growing real incomes and strong demand drove the recovery in the domestic consumer market. The share of consumer spending in GDP grew from 55% in 2001 to 57% in 2002 (more than any other component of GDP).

Agriculture, although rising, remains a small share of GDP. In 2003, agriculture accounted for 13% of GDP, while the food processing industry contributed another 7%. The food processing industry employs only 2.1% of the population, although agriculture employs an additional 19.7%. The average growth rate of the food industry exceeds the GDP growth rate. In 2003, the average growth rate of the food processing industry reached an impressive 20%, however a slow down occurred in 2004.

Because of relatively low incomes, sales of the vast majority of US food products available in the Ukrainian market are limited because most products are of premium quality and value added. U.S. food products are demanded in some niche markets for wealthy consumers (1.5-1.8% of the Ukrainian population) and the growing middle class (12-15% of the population). Concomitantly, the rapid development of the Ukrainian food processing industry is opening the door for U.S. ingredient suppliers. (Please refer to GAIN Report #4013.)

Investments

Due to the hostile and nontransparent business environment, the inflow of foreign direct investment (FDI) is not very significant when compared to FDI flowing into Eastern Europe and Russia. For the past three years, the inflow of foreign direct investment into Ukraine stabilized at an annual average of \$700 million dollars. The aggregated amount of FDI into Ukraine as of January 1, 2004 totaled \$6.568 billion dollars. The net increase of foreign capital in 2003 was \$1.319 billion dollars, almost doubling the amount recorded in 2002.

Traditionally, the food industry and agricultural processing sector is one of the most attractive in terms of investment (17% of total FDI or \$852.3 million dollars). The U.S. investment share is approximately 16%. The following industries were recipients of FDI; tobacco, beer, beverage, confectionery, food concentrate (dry goods and condiments) and sunflower oil sectors. Additionally, investments in sugar, ice cream, meat, fish, dairy, fruit and vegetables processing have also increased considerably. Foreign investment is concentrated in certain regions of Ukraine. Kiev and the surrounding area received over one-third of all foreign investment.

Retail trade

The growth in the local retail sector and the growing presence of European retail chains has resulted in increased competition. These factors contributed to the growth in sales of processed food products in the expanding number of supermarkets and hypermarkets. In 2002, the retail network was comprised of approximately 600 hypermarkets and supermarkets. In 2003, of the number of outlets continued to expand due to overwhelming acceptance by consumers. Ukrainian supermarkets maintain the widest product mix and the largest proportion of imports in all categories of goods. Despite the rapid expansion of supermarkets in large urban areas, many food products continue to be sold through open-air markets and small convenience stores. In 2003, retail sector gross sales reached 41.5 billion UAH (\$7.7 billion), despite the fact that only 55% of all food products were sold through the 38,442 grocery stores and supermarkets. According to retail experts, gross sales for the top 10 food retail chains in Ukraine reached between 1.0 and 1.2 billion UAH (\$188 and \$225 million dollars).

Foreign trade

Ukraine is not a WTO member and maintains relatively high import duties on imported food, especially for products produced in the country. It also maintains systems of veterinary and sanitary control, state standards and imported goods certification. All these non-tariff barriers to trade add to high distribution and shipping costs.

Due to free trade agreements Ukraine signed with Macedonia, Russia and other Commonwealth of Independent States (CIS) countries, food and agricultural products from these countries have price advantages over imported products from the United States. In 2003, as much as 31% of Ukrainian imports were sourced from EU countries, 25% from CIS states, and 21% from the Americas. For 2003, the U.S. share of total food imports (HS 1-24 groups) accounted for 2.3% (\$29.6 million). In 2004, agricultural imports from the United States are expected to double. (Note: These are official numbers that fail to capture the significant volume of products imported through the shadow economy. They also disregard the impact of the poultry import ban, which was in place from 2001 to 2003.)

Ukraine is in the process of modifying sanitary and phyto-sanitary standards in conjunction with preparations for accession to the WTO. Some existing standards and veterinary

regulations have blocked trade of U.S. ready to eat products, food ingredients, fish, poultry and red meats.

Possessing a vast agricultural sector, Ukraine is and will continue to be a major exporter of food and agricultural products, especially within the CIS region. Since the late 1990's, Ukraine has become an established supplier of grains and oilseeds to the world market. Most Ukrainian grain is sold to the Near East, Eastern Europe and EU countries. Since 2001, Ukraine has become a large exporter of dairy products, primarily supplying Russia, former CIS countries, Japan and Near East. Exports of processed and high value added products are not significant, but quickly growing.

Advantages and Challenges Facing U.S. Products

Advantages	Challenges
Rising incomes and structural changes in consumption lead to greater demand for value added, top quality food products.	Strong competition in the local market from domestic producers and increasing imports from CIS (mainly from Russia), EU and Baltic countries.
Investment growth in the food processing industry increases demand for additives and other ingredients not produced in Ukraine.	Long-established consumer preference for domestic fresh products with no additives. Current veterinary requirements impede the import of red meat and biotech products.
Joining the WTO will make access for imported goods in the Ukrainian market easier.	High distribution, shipping costs and import tariffs.
Growth of international fast food and restaurant chains in Ukraine that use standard procurement systems and that source food ingredients from the US.	Strong competition among imported food products and ingredients.
The retail sector is looking for innovative high value added food imports.	Low awareness of U.S. products; extremely low presence of U.S. products on the shelves of supermarkets and discounters.

U.S. food and agricultural products traditionally suffer from lower customer awareness in Ukraine. Several constraints and misconceptions have contributed to the small market presence of US foods:

- U.S. companies have little reliable information about the country, current market opportunities and potential business partners.
- Minimum quantities offered are often too large for the Ukrainian market.
- A perception that persists among Ukrainian importers that landed costs of U.S. products will be higher compared to European products due to higher transportation costs.
- The perceptions that U.S. exporters are simply too far away to follow market trends and service the Ukrainian market.

SECTION II. EXPORTER BUSINESS TIPS

Local Business Practices and Customs

Entry Strategy

There is no single market entry strategy recommended for new-to-market exporters. First, the exporter should define whether Ukraine is a major market for the product, or if only occasional deliveries will be made. The following factors should be considered:

- Market product need, given consumers income trend and particular food sector development prospects (market research in order to assess product prospects maybe warranted);
- Availability of similar products, produced domestically (often Ukrainian producers are effective in building barriers to trade by lobbying the GOU, Parliament, veterinary or health inspection services).
- Calculation of the landed cost of a product in order to make price comparisons vis-à-vis competitors.
- Availability of similar products from EU or FSU. Also, comparative advantages / disadvantages of U.S. products relative to products from major competitors (e.g. quality, price, transportation expenses, packaging, labeling, etc.)
- Availability of a local distributor familiar with the product. It is advisable to initiate personal contact in order to discuss marketing strategies, funding for advertising, slotting allowance, in-store promotions, tasting and sampling events. Suppliers may also want to consider trade fair participation to increase awareness of their products.
- Tariff and non-tariff regulations affecting the product. (Note: in some cases big Ukrainian food producers lobby tariff reductions for much needed ingredients and have the clout to settle veterinary or SPS problems should they arise.)

Currently, most U.S. food and agricultural product exporters work through a Ukraine-based importer or through the procurement service of the buyer (the latter is the most convenient if there are only 2 or 3 potential buyers). Local distributors are more flexible, usually have established marketing channels and can provide local customers with short-term (5-30 days) credits in kind. They are also responsible for the entire logistical chain and inland transportation. Due to frequent changes in Ukrainian legislation, non-transparent custom clearance rules, SPS and veterinary procedures and corruption, it is recommended that the Ukrainian partner handle all logistics. When supported by the domestic processing industry, importers are powerful and influential enough to lobby for import duty reductions (import of granulated hops) or import quota increases (cane raw sugar quota for 2003). Some Ukrainian distributors have already established representative offices in major exporting countries.

U.S. companies should approach potential Ukrainian partners with extreme caution. While information on Ukrainian companies has improved, there is still a significant dearth of background data and credit histories on potential Ukrainian distributors. This presents the greatest obstacle to finding reliable, competent distributors. In order to obtain a due diligence report on a potential Ukrainian partner, a U.S. company is advised to contact either a law firm or an internationally accredited financial service company. It is advised that all U.S. companies consider legal counsel before and while doing business in Ukraine. Ukrainian laws and regulations are vague and open to interpretation, providing ample corruption opportunities for officials at every bureaucratic level. U.S. businesses are advised that establishing a partnership with a Ukrainian company is a challenge that is beyond the control of the U.S. partner and his legal advisors.

If the Ukrainian market looks promising, it is recommended a representative office be established to deal with buyers directly. Personal relationships are very important in Ukrainian business practices and often problems cannot be effectively resolved over the phone. It is a very common practice in Ukraine to purchase inputs directly from the producer. Even if the exporter's policy requires importers to work through the foreign-based distributor, most Ukrainian partners will still attempt to contact and work directly with the producer. In the past, many U.S. companies dealt with Ukrainian partners through a Russia based representative office (mostly Moscow). This is no longer the case because trade regulations and laws that were once common between the two nations differ more and more. (Note: the Ukrainian food ingredient market is small at the moment and relatively few products can justify a representative office in Kiev).

Select U.S. products may also enter the Ukrainian market through a different route; via a Ukraine-based U.S. intermediary able to manage the distribution scheme more efficiently than a Ukrainian importer. This is vital if the importer lacks technical skills and expertise in product promotion.

Exporters of high value added products must note that larger Ukrainian retail chains use their own procurement centers. Few wholesalers undertake nationwide distribution, and very few carry a complete range of products. In many cases, supplier choices are based on informal personal relationships and ownership ties, rather than driven by quality and price factors.

General Consumer Tastes and Preferences

Consumer preferences differ significantly among various income and age groups. Similar to other nations, young consumers tend to experiment with new products, but many of them remain at the "tasting level". Middle-aged and elderly consumers are much more conservative in their taste preferences and often treat new products with caution. Consumers of all ages and income groups are highly patriotic in their choices and often will not buy an imported product if a domestically produced one of comparable price and quality is available.

All categories of consumers analyze the content/ingredients of products with great care. There is a widespread belief, that preservatives, stabilizers, colorants and flavorers are not healthy and one should avoid them if possible. However, consumers pay little attention to fat, sugar or protein content. The trend for healthier food consumption (low fat and reduced cholesterol, sugar free) is not yet evident in Ukraine. The diet of many low-income people is not nutritionally balanced and health concerns are found only in big cities, where consumers are wealthier and can afford more expensive products.

Biotech products have a negative public perception in Ukraine and compulsory labeling makes them easily identifiable in supermarkets. Thus far no biotech labeled products have been observed on the domestic market and Ukraine lacks the technical abilities necessary to enforce this requirement. Ukrainian legislation on biotechnology is in development and is difficult to forecast what measures will be adopted.

With average per capita income still quite low, Ukrainians spend approximately 60% of their incomes on foodstuffs. Prepared home meals are preferred over dining out. Women account for 49% of the total working population (20.2 million people) and contribute to the increased demand for meals consumed away from home, easy to cook and ready-to-eat products.

The market trend for frozen and convenience food is relatively new in Ukraine, but with a large proportion of two-income families and growing incomes of city dwellers this market segment is expanding very rapidly. It should be noted that microwaves are not as widespread in Ukraine as in the U.S. and Western Europe.

Almost 33% of the population lives in rural areas. Their incomes are quite low and many people rely on subsidiary household plots to provide staple foods. Many rural families sell vegetables, meats and traditional dairy products in open-air markets. The majority of their consumers are low income and elderly (these two categories overlap considerably).

Food Standards and Regulations

For an extensive explanation of Ukrainian Food and Agricultural Import Regulations and Standards, a prospective exporter should refer to Ukraine FAIRS GAIN Report #4010, which is available on the FAS/USDA web site. An abbreviated review of Ukrainian import regulations and food standards is provided below.

Ukraine maintains a complicated food safety control system that is supervised by various state agencies, which often have overlapping functions. The following agencies of the Government of Ukraine (GOU) are involved in assuring the safety of domestically produced and imported food products, and animal and plant health issues:

- State Epidemiological Service establishes food safety standards and is responsible for ALL aspects of food safety;
- State Department of Veterinary Medicine is responsible for animal health, safety and wholesomeness of meat, seafood and other products of animal origin;
- Main State Phytosanitary Inspection Service is responsible for plant health issues;
- State Committee of Ukraine on Technical Regulations and Consumer Policy is responsible for compliance of food products with existing quality and safety standards;
- State Ecological Inspection Service is responsible for radiological and environmental control.

Ukraine is not a member of the World Trade Organization (WTO) and does not notify its trading partners of proposed regulatory changes. Therefore, it is difficult for foreign suppliers to be aware of the most current food safety regulations. U.S. suppliers should work with experienced importers who are familiar with the latest import requirements. Currently, certain sanitary measures used in Ukraine are inconsistent with WTO provisions, with standards established by international standards setting bodies, and with internationally accepted trade practices.

Imported food products must meet the same requirements as domestically produced foods. While enforcement of food safety norms has been generally effective, outdated nutritional norms have not been rigorously enforced.

All food products sold in Ukraine must have Ukrainian language labels attached to the package that contain the following information:

- 1) Name of food product;
- 2) Nominal quantity of food product (weight or volume in metric system measurement);
- 3) List of all ingredients found in the food product, including other food products and food additives used;
- 4) Nutritive values and energy, if applicable;
- 5) Expiry date, or the date of production with indicated shelf life;
- 6) Storage conditions;

- 7) Name, country, address of producer, packer, exporter and importer of the product;
- 8) Terms of use (if any);
- 9) Presence of genetically modified organisms (GMO);
- 10) Consumption of food product warnings for certain consumer categories (children, pregnant, senior people, athletes etc.)

Stick-on labels that meet Ukrainian food safety law requirements are allowed and can be affixed on the side or over the standard US label. Customs authorities require compliance with the Ukrainian labeling requirements prior to granting final clearance to the product. Some importers prefer to deal with products that already contain labels and meet Ukrainian requirements while others prefer to attach labels in the customs licensed warehouse in Ukraine. Health claims and statements targeting particular consumer groups (children, pregnant women, athletes) are prohibited without prior approval from the Ministry of Health.

The product's expiration date (or shelf life indication containing the date of production) must appear on the label. Although Ukrainian food safety legislation allows producers to determine the shelf life of the product, it is highly advisable to verify with the importer whether it meets existing Ukrainian technical regulations (GOST or DSTU).

Biotechnological content labeling requirements have been in place since November 2002. However, no biotechnological content threshold has been established by the GOU. Biotech labeling enforcement has been weak and FAS-Kiev has not seen a single label referring to the biotech content in Ukraine.

Ukraine maintains a positive list of food additives. Recommendations from the CODEX Alimentarius Commission, an international food safety standard setting body is considered in approving new food additives; however Ukrainian authorities conduct their own risk assessment for each new substance. Importing food products that contain food additives that have not received official approval is prohibited.

Ukraine establishes its own maximum residue limits for chemical and biological contaminants in food products. The Ukrainian sanitary service recognizes the norms established by the Codex Alimentarius Commission for non-registered pesticides in the case of imported foods.

Many imported food products are subject to mandatory certification in Ukraine. The applicant (either exporter or importer) is responsible for the cost of the certification. There are usually two options available to exporters and importers depending on the value and the frequency of shipments. The first option envisions compliance of a foreign facility to existing Ukrainian norms and regulations on quality and safety. The supplier receives a certificate of conformity valid for two-to-three years that avoids having to certify each shipment. The second option involves certification of each product shipment with mandatory laboratory tests upon arrival in Ukraine.

All food products of animal origin are subject to veterinary surveillance and control in Ukraine. A prospective U.S. exporter should refer to FAIRS GAIN Report #4010 for more information even if the exported commodity is not subject to veterinary controls in the United State. A Ukrainian state veterinarian conducts inspections at the border of canned products that contain any amount of meat or animal fat, animal feeds of plant origin (such as soybean meal), ready-to-eat seafood products, and frozen fish. The report also contains multiple reference lists.

General Import and Inspection Procedures

Import regulations in Ukraine are similar to regulations found in other countries. All applicable duties and taxes are collected by customs authorities upon clearance of imported goods at the border, unless the cargo is forwarded to a bonded warehouse. Ukraine maintains both an *ad valorem* and a fixed minimum per kilogram duty rate for the majority of food products. The higher rate of the two is applied. For certain less-expensive products, the official *ad valorem* import duty as a percentage of value is very small, thus, the official *ad valorem* duty would never be applied. Charged in Euros, import duties have been slowly rising over the last three years as the U.S. dollar has devaluated relative to the Euro. At this time, the only commodity subject to a quota restriction is raw sugar.

Agricultural and food products imported into the customs territory of Ukraine is subject to sanitary testing, compulsory certification, radiological, veterinary and/or phytosanitary inspections. Every shipment arriving in Ukraine is inspected and sampled regardless of the statements made in the accompanying health certificate. Custom clearances and co-related inspections are fee-based and are viewed by many regulatory agencies as a source of additional revenue. It's common practice for two or more GOU agencies to test import samples for the same safety indicators. The testing procedure takes up to 7 days, which makes the import of some highly perishable products difficult at best or impossible.

Due to small import volumes from overseas, U.S. exporters should be prepared to ship mixed product loads in one container. A separate health certificate is required for each homogenous product lot within the container. There may be specific import requirements (alcohol, tobacco, etc.) or prior notice requirements for certain products. At the planning stage, exporters are advised to verify with their importer what types of controls are applicable to the product. Any food product (except those produced for personal consumption), food raw materials and agricultural products are prohibited entry into Ukraine without documented evidence of their quality and safety. Control over adherence to the procedure of food and agricultural product imports rests with the Customs Service of Ukraine. The product will not be granted final clearance until all legal procedures are met. The following documentation is required for customs clearance:

- Copy of a contract and an invoice;
- Bill of lading;
- Freight custom declaration;
- Certificate of conformity;
- State sanitary and epidemiological expertise certificate, (or certificate on state registration of special food products);
- Veterinary certificate (if applicable);
- Import permit and original phytosanitary certificate (if applicable);
- Manufacturer's Certificate of Quality.

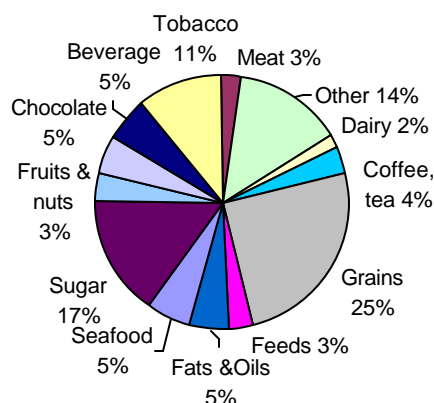
Ukrainian is the only official language recognized in Ukraine. All documents must be bilingual, submitted in Ukrainian or be accompanied by an official translation.

Competition

For the past six years, Ukraine has been a net exporter of agricultural and food products. During this period exports totaled approximately \$10.1 billion dollars, and imports \$6.5 billion dollars (HTS 1-24 groups). In 2003, total exports of agricultural products from Ukraine reached \$2.7 billion dollars (17% growth from 2002), exceeding agricultural imports (\$2.2 billion dollars). For 2002, agricultural imports accounted for \$1.1 billion dollars,

excluding wood products. Rapid import growth occurred in 2003 because of the grain crop failure of MY 2002/03.

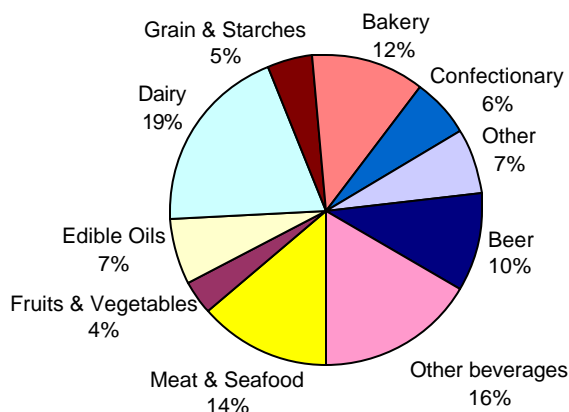
Import of Agricultural Products in 2003



Source: State Statistics Committee of Ukraine

The development of the food industry in Ukraine has led to the significant increase in raw materials and additives used for foodstuff production and comprise the majority of Ukrainian imports. For more information on export opportunities in Ukraine's food processing industry, please refer to UP4013 Food Processing Ingredients Sector Report found on the FAS homepage. Demand for ingredients increased due to growth of meatpacking and dairy processing industries, increased production of fish products, confectionery and beverages.

Ukrainian Food Processing Sub-Sectors*



Source: State Statistics Committee of Ukraine

*By volume of the produce; tobacco industry is not included

In 2000-2003, the following commodities were imported in increased quantities:

- Food additives (stabilizers, emulsifiers, flavorings, proteins, pigments, ferments, albumin, oil-and-fat mixes, modified starch etc.)
- Poultry and fish
- Vegetable and fruit puree, dry concentrates

- Dried fruits (dried apricots, prunes, raisins)
- Spices (pepper, vanillin, cardamom, cinnamon)
- Cocoa-ingredients (bean, butter, powder), dried yogurt
- Nuts (excluding hazelnut and walnut, produced in Ukraine)

Some imported soya products are used as ingredients in food and compound feed industries (such as soya meal and flour, soya protein concentrates, lecithin, vegoil mixes and isolates on soya base for confectionery, dairy and meat industries).

Food products imported from EU and CIS companies are now the major competitors for U.S. commodities in Ukraine and will continue to be in the foreseeable future. In 2003, as much as 31% of imports were sourced from EU countries, 25% from CIS, and 21% from the Americas.

In 2003, the share of food imports from the United States (HTS 1-24 groups) as a percentage of total food imports was approximately 2.3%, or \$29.6 million dollars (2002 - \$68.1 million dollars). In 2003, food imports from the United States declined by more than half compared with 2002. U.S. companies dominated in supplying live trees & plants in 2003 (\$2.1 million dollars, or a 15.2% share of total imports). Imports of vegetable products totaled \$1.0 million dollars or a 21% share of total imports.

U.S. suppliers have actively explored the Ukrainian market. Out of total U.S. agricultural exports to Ukraine in 2003, dairy products accounted for 4.2%, soybean meal - 1.5%, miscellaneous edible preparations - 1.6%, pet food - 4.4 %, frozen fish & seafood - 5.3%, alcoholic beverages - 3.6 % and tobacco products for 7.3%. Supplies of poultry meat and offal have rebounded and are growing quickly after almost a 3-year brake.

For many staple products, domestic production meets demand. Imported food and agricultural products have difficulty competing with domestic products due to high import duties and generally efficient production of unsophisticated food products. Imports add to the variety of foods available on the market and also include products that are either not grown in the country or for which domestic production is insufficient to meet domestic demand.

SECTION III. MARKET SECTOR STRUCTURE AND TRENDS

Retail Food Sector

Open Air Markets

Given relatively low salaries in small towns and rural areas, open-air (farmers) markets continue to supply the majority of Ukrainian consumers with foodstuffs. Most salespersons in these markets are rural dwellers selling their own produce that was grown on household plots. Rural middlemen sell meat products they procured in neighboring villages. Some open-air market retailers open small kiosks, while others continue to use counters provided by the market administration. All products sold are subject to veterinary and sanitary surveillance, which is conducted by market veterinary and sanitary inspectors. All products that are tested in market labs are labeled.

In 2003, according to official GOU statistics, there were 597 open-air markets selling foodstuffs (10% less than in 2002). Out of 597, 99 markets are located in Kiev and have a total floor space of 599,000 square meters. In 2003, the following regions contained the

largest number of open-air markets in Ukraine: Donetsk region, Odessa region, Dnepropetrovsk, Autonomous Republic of Crimea, Lugansk region, and Lviv region.

The majority of consumers believe that purchasing food at open-air markets is cheaper than in supermarkets. Elderly consumers also believe that products found at wholesale open-air markets are organic and of the higher quality.

According to some estimates, 40-50 percent of total food product transactions occurred in open-air retail outlets in 2003. For some commodities (meat products and offal), sales in open-air outlets account for 90%. Sales of fresh vegetables, fruits, honey, and dried fruits are also dominant in open-air markets. Sales of dairy, sunflower oil and alcoholic products have gradually moved from open-air markets into retail stores, mostly out of necessity. Open-air markets lacked storage equipment, had persistent quality concerns and a significant share of counterfeit alcoholic products. These markets also suffered from low service standards. Also, local authorities are pressuring these outlets to guarantee appropriate sanitary conditions. The only U.S. food product that has been spotted in many open-air markets all over Ukraine is U.S. poultry meat and offal. In many cases, these products are smuggled into Ukraine and remains popular among consumers due to very competitive prices.

Some central markets located in large cities have become elite retail institutions offering high-quality products for wealthy consumers looking for a unique shopping experience. The best examples are Bessarabskiy and Vladimirskiy markets in Kiev. These century old open markets located in the central part of the city service residents in Kiev, including foreign diplomats and the Ukrainian elite. These markets are of interest to American exporters of delicatessen meat products, seafood, semi-prepared and microwaveable foods, mixtures of exotic dried fruits, nuts, elite confectionery, and alcohol drinks.

Supermarkets, Hypermarkets and Discounters

This segment of the Ukrainian retail sector is developing the quickest in bigger towns and cities, despite only being responsible for approximately 23-24% of retail food sales. In 2003, 38 hypermarkets were identified in Ukraine, a 90% increase over the previous year. The average Ukrainian hypermarket is 3,895 square meters. The number of supermarkets (universal self-service stores) in 2003 reached 622 (9% increase from 2002). The average floor space of a Ukrainian supermarket is 822 square meters.

An average supermarket carries between 25 – 30 thousand items. Approximately 80-90 percent of products sold are of Ukrainian origin. There is a wide range of dairy products, fish, meat, bakery, and spirits and constitutes the majority of the products. The largest chains work with almost 1,000 different suppliers represented by large wholesale companies, producing companies, and importers. Local chains are actively introducing western standards and quality assurance mechanisms.

Foreign chains "Billa" (Austria), and the only full fledged discount chain "Metro Cash and Carry" (Germany), as well as SPAR (the Netherlands) entered the Ukrainian market between 2001 - 2003. Metro is planning to build seven Metro C&C centers in Ukrainian cities with a population over one million. Currently, many companies are planning to begin operations in the largest cities of Ukraine. The most likely entrants are Auchan (France) and Russian chains "Paterson" and "Pyaterochka". Tesco (Great Britain) and Carrefour (France) are conducting market research. In anticipation of fierce competition, local retailers are rapidly expanding. Expansion plans have been announced by Fozzi Group, Furshet chain (Garantiya-trade LLC), Velyka Kishenya (Quiza-trade LLC), and ATB convenience store network (corporation ATB).

Domestic networks are intensively developing. "Furshet" has purchased buildings from former Soviet self-service stores and turned them into modern supermarkets. Other chains are also attempting to keep up with industry leaders. The "Velyka kishenya" chain recently took over the Begemot chain, which experienced financial difficulties. Many analysts in Kiev suggest that additional supermarkets are needed in Ukraine. Currently, supermarkets compete primarily with traditional open-air markets rather than with each other. Larger supermarkets in Kiev, and in some other major cities, have slowly evolved into shopping malls where shoppers can also shop in boutiques and watch movies while visiting the big "anchor" food retailer.

Convenience and Over-the-Counter Small Stores

The number of convenience stores in Ukraine is significant and is presently the second largest retail business sector after open-air markets. Convenience stores are located all over Ukraine, in big cities, towns and big villages. Many of them are privatized Soviet convenience stores that have not changed their trade practices much. Privatized by their employees, these stores often have no resources for renovation, new refrigerators, showcases or other essential equipment. Concomitantly, some supermarket chains (ATB, Fozzi Group) are attempting to develop modern-style retail outlets by purchasing and renovating stores in attractive locations in larger cities.

Once popular, small kiosks that offered a wide variety of food products, tobacco and alcoholic beverages, are quickly losing popularity. A significant number of these operations remain on the streets, but are slowly evolving into cigarette and snack dispensaries, as well as into hot-dog stands. Only non-alcoholic beverages, beer, chocolate bars and potato chips are usually sold at kiosks. Facing stiff competition from supermarkets, many convenience stores have switched to 24-hour operations and have decreased the number of food products offered.

The average convenience store is between 300 to 500 square meters. Product lists include 1,500 to 3,500 articles. The variety of products available in these stores is not as extensive as in supermarkets, facilities not as nice and products are often more expensive. These outlets are popular among pension age consumers who prefer to shop closer to home and who are still distrustful of purchasing goods in modern supermarkets. Convenience stores also target consumers who purchase products with very short shelf life (bread, dairy products, fruits and vegetables, etc.). They are popular in small Ukrainian towns where construction of supermarkets is not profitable.

HRI Food Service

The HRI sector in Ukraine remains small, but is developing quite rapidly. In 2002, the number of restaurants, cafes, bars and other HRI institutions in Ukraine exceeded 5,200. Ukrainian restaurant output totaled \$526 million dollars in 2002, a 12 percent increase compared with 2001 (\$470 million dollars).

New fast food outlets and restaurants with international-style cuisines have begun to alter the structure of the food service sector. The market niche for expensive and elite restaurants is saturated, so the lower cost mass market is developing. Existing restaurants are divided into three categories: fast food, mid-level restaurants, and restaurants with "high-quality cuisine". The majority of outlets belong to the "mid-level restaurant" group. With over 2.3 million visitors every year, tourists have become the major driving force behind the success of the HRI sector and the introduction of new food products to the Ukrainian market.

In addition to fast food establishments that offer pizzas, hot dogs and hamburgers, outlets of various ethnic cuisines, such as Mexican, Chinese, Vietnamese, Japanese, Italian, Indian and others, have entered the food service industry. However, the majority of customers prefer family-style menus featuring traditional Ukrainian food. In addition to McDonald's (with 52 restaurants in Ukraine), there are other fast-food restaurant chains like McSmak, "Pizza Chelentano" and "Kartoplyana khata" (Potato house), "Shvydko", "Rostik's", etc.

In 2003, the representative office of Kraft Foods in Ukraine announced plans to create a large café chain under the name of Jacobs coffee brand. Over the next three years the company will create a network of 150 restaurants that will be franchises. There will be independent cafes, cafes in shops and fast food restaurants. In contrast to the Nestle coffee shops network, Kraft Foods will attempt to develop a natural coffee culture.

HRI Prospects: The HRI sector will continue to grow. The number of customers is expected to increase as European out of home eating habits becomes more and more popular among wealthy Ukrainians. Restaurant chains consisting of coffee bars, healthy food restaurants (separate eating, healthy food), and a fast-food fish chain, are not developed in Ukraine. These are good prospect areas for new restaurants.

Food Processing Sector

Ukraine is endowed with inputs critical to establishing a strong agricultural sector. If the government is able to sustain reforms in the agricultural sector designed to increase farm efficiency and stimulate growth, then Ukrainian agriculture will continue to see growth. However, it's important to note that many policy makers are still very actively attempting to decrease efficiencies as witness by the passing of the New Law on State Support of Agriculture in September 2004. Opponents to this law are attempting to prevent implementation of many of the provisions because they will decrease farm efficiency, drain the national treasury and are deemed to be WTO inconsistent.

The food-processing sector in Ukraine has developed rapidly in the past 5 years and contributed an average of 5.1% to GDP over the same period. The food industry's share in manufacturing is 18.3%. In 2001, the industry grew by 26.0%, slowed down in 2002 but still grew by 8.4% and still recorded a strong 6.0% growth rate in 2003. In 2003, total output of the Ukrainian food industry totaled \$8.1 billion dollars (2002 - \$7.3 billion dollars). Over 19,000 enterprises operate in the food industry of Ukraine. The fastest growth rate is found in fruit and vegetable processing, edible oils production, pastry and biscuits, baby food and alcoholic beverages production.

Total imports of agricultural products to Ukraine in 2003 reached \$2.17 billion dollars, a 95% growth rate over 2002). Imports of food ingredients are expected to reach \$1.52 billion dollars. 2003 was unique because Ukraine experienced extremely bad winter weather resulting in record low cereal crops. Major imported products for the processing industries included poultry, fish, palm oil, cocoa products, juice concentrates, spices and seasonings, vegetables, additives, tobacco and others.

Following the reversal of the 2-year poultry ban in 2003, shipments of U.S. poultry resumed after the successful renegotiation of the veterinary certificate in the fourth quarter of 2003. U.S. products have slowly regained market share, recapturing market share from both Europe (72% import market share in 2003) and Brazil (28% import market share in 2003). In 1999-2001, the U.S. supplied 85% of all poultry imports. Mechanically Deboned Poultry Meat (MDM) is a major commodity imported from the United States for the Ukrainian food

processing industry. Except for poultry, relatively small quantities of U.S. products are used in the food-processing sector.

The development of the food processing industry is currently impeded by inadequate domestic supply of raw agricultural products and limited export possibilities. Only few food processors comply with EU quality requirements and packaging standards (mainly dairy & meat, confectionery, and beverages). Large food processors purchase raw materials and food ingredients directly from foreign exporters. Large wholesalers and distributors also supply the sector.

Sector trends: The Ukrainian food processing industry will be driven mainly by increased demand, through production of dairy products (especially hard cheese and butter). Production of beef will be driven by demand in Russia and some former Soviet Union countries.

(Note: Please refer to Ukrainian Food Processing Sub-Sectors diagram under the Competition section, page 11.)

SECTION IV. BEST HIGH VALUE PRODUCT PROSPECTS

Given the potential of the Ukrainian agricultural industry and relatively low incomes, U.S. high value added products will penetrate some niche markets, especially for those products that are not produced in Ukraine or produced in limited quantities. In many cases, Ukrainian agriculture is not capable of producing products of consistently high quality (e.g. high quality beef stakes and pork medallions). There are markets for specialty products including low-fat, low-salt and sugar-free products, cake & bread mixes, corn meal, Graham Crackers and chocolate chips. U.S. suppliers could also supply new market segments that are just beginning to develop. This includes microwaveable and semi prepared food as well as TV-dinners. Potential importers must be aware that promotion of innovative or new to market products is expensive.

Other potential U.S. export items include snack foods, raisins, dried foods, nuts, spices, peanut butter, frozen and dried yogurt, soft drinks, frozen juices, fruit & vegetable pure and concentrates, fresh fruits and vegetables, wine, frozen foods, meat (esp. chicken and turkey), pasta preparations, frozen and canned seafood, frozen and canned vegetables and fruits, soft cheese, soya sauces, salad dressings and breakfast cereals, baking improvers and bread mixes, and dry gluten. Quick-to-prepare main and side dishes as well as ethnic international foods are all gaining in popularity.

Products with Best Sales Prospects in Ukraine

Product Category	2003 Market Size	2003 Import	3-Yr. Avg. Annual Import Growth	Import Tariff Rate	Key Constraints Over Market Development	Market Attractiveness for the USA
Poultry	226 ths. tons	86 ths. tons	24%	30% but no less than € 1.5 per 1 kg (€ 0.7 per 1 kg of poultry semi-carcasses, quarters, legs, and	High customs duties, quotas for deliveries from free economic zones to the rest of Ukraine; competition with Brazilian and EU producers;	U.S. product has well-established positions; Low prices attract a lot of low-income consumers. Local producers will not be able to satisfy

				parts of legs) +VAT in the amount of 20%+0.2% for customs services *	Quick growth of domestic production; Perception of U.S. product as cheap and of low quality.	the demand in near future. U.S. product has the right price/quality ratio compared to Brazil and EU product.
Beef	628 ths. tons	2 ths. tons	Less than 1%	€ 1 per 1 kg +VAT in the amount of 20%+ 0.2% for customs services	Lack of valid veterinary certificate; High import duties, consumer unawareness of U.S. high quality beef; Sizable domestic production Smuggling from Poland, Germany, and Argentina. Lack of modern storage facilities	Lack of capacity for cattle rearing; Insignificant specialized beef production; Constantly growing beef prices; Niche market for meat delicacies (steak, etc.); Fast HRI development.
Pork	662 ths. tons	10 ths. tons	Over 600%	€ 1 per 1 kg +VAT in the amount of 20%+ 0.2% for customs services	Lack of valid veterinary certificate; High import duties; Gradual recovery of local production; Competition from Brazilian pork and Polish smuggled pork; Lack of modern storage facilities.	23% stock decline in 2003; shortage of pork in the country; high prices; Reduction of European pork deliveries due to prices growth. Demand for stable deliveries of cheap high quality product.
Fish and Seafood	510 ths. tons	215.2 ths. tons	Less than 1% in volume, but over 20% in value	5 – 20% (shellfish - € 1 per 1 kg, clams € 0.2 – 1 per 1 kg) +VAT in the amount of 20%+ 0.2% for customs services**	High import duties, smuggling, regular deliveries of high quality produce from Norway. Shortage of suitable trade equipment at retail trade outlets. Deficit of proper storage facilities with below –20C temperature.	Growing demand for higher quality seafood from consumers; Very modest assortment on the market. Skyrocketing demand from HRI sector.
Dried fruits and nuts (exclud.	103.5 ths. tons	24.2	15%	0% in packages less than 10 kg (20% but no	Sharp competition with Iran and Turkey. Desire of packers	Intensive development of confectionery industry and start

peanuts)				less than € 0.2 per 1 kg in packages less than 10 kg; € 0.1 per 1 kg of dried fruits excluding raisins) + VAT in the amount of 20%+ 0.2% for customs services	to save on raw stock, procuring low quality stock from Iran, Uzbekistan, and Afghanistan	of retail sale of rare dried fruits (exceed world prices by 3 – 6 times). High quality of U.S. product; Development of premium-class confectionery products
Canned fruits and vegetables	413 ths. tons	0.6 ths. tons	Less than 1%	€ 1 per 1 gross kg +VAT in the amount of 20%+ 0.2% for customs services	High competition from EU products; Smuggling; Cheap canned food niche occupied by Ukrainian trademarks. The majority of population is inclined to supply its own needs with home-made canned fruits and vegetables	High and growing demand for value added imports at the expense of, and gradual rejection of home-produced products; High-quality product niche is not completely filled.
Wine and spirits	224.3 mn dal	7.9 mn dal	93%	€ 0.5 per 1 liter of beer, € 2-3 per 1 liter of wine, € 10 per 1 liter of champagne, € 7.5 per 1 liter of 100% alcohol, +VAT in the amount of 20%+ 0.2% for customs services + excise tax (UAH 0.21 per 1 liter of beer, UAH 1.6 per 1 liter of champagne, UAH 0.8 per 1 liter of wine, UAH 16 per 1 liter of 100% alcohol)	High import duties, tough competition with Ukrainian-made spirits and drinks produced in the CIS states	Relatively high level of strong alcohol drinks consumption; Demand for exotic drinks (whiskey, gin, rum, bourbon). Government policy aimed at increasing wine and beer consumption.
Pet food	100 ths.	53.2 ths.	18%	€ 0.05 per 1 kg +VAT in	Large supply of Russian-made	Traditionally large number of

	tons	tons		the amount of 20%+ 0.2% for customs services	cheap pet food; Smuggling; Long lasting tradition of pets feeding with table leftovers; Long registration and certification procedures.	home pets; Increased population incomes followed by growing demand for ready to use pet food. Comparatively low import duty
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** Imports of poultry are conducted almost exclusively through the Free Economic Zones, thus import tariffs are circumvented. For more information see GAIN Report 3011.*

*** An interested reader should refer to GAIN Report 4012 for more information.*

SECTION V. KEY CONTACTS AND FURTHER INFORMATION

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TABLE A. KEY TRADE & DEMOGRAPHIC INFORMATION

	Y2002
Agricultural Imports From All Countries (\$MI) /U.S. Market Share (%)	1127.3/6
Consumer Food Imports From All Countries (\$MI)/U.S. Market Share (%)*	815.0/4
Edible Fishery Imports From All Countries (\$MI)/U.S. Market Share (%)*	86.4/3
Total Population (Millions)/Annual Growth Rate (%)	48.0/-0.8
Urban Population (Millions)/Annual Growth Rate (%)	32.3/- 1
Number of Major Metropolitan Areas	7
Size of the Middle Class (Millions)	14.4
Per Capita Gross Domestic Product (U.S. \$)	860
Unemployment Rate (%)	3.6
Per Capita Food Expenditures (U.S. \$),per year	469
% of Female Population Employed	52.3
Average Exchange Rate US\$1	5.33 UAH

Source: State Statistic Committee of Ukraine

*HTS 1-24 groups

TABLE B. CONSUMER FOOD & EDIBLE FISHERY PRODUCT 2001/2003* IMPORTS

Ukraine Imports \$ MI	Imports from the World			Imports from the U.S.			U.S Market Share, %		
	2001	2002	2003	2001	2002	2003	2001	2002	2003
CONSUMER-ORIENTED AGRICULTURAL TOTAL	325.4	361.7	326.2	60.5	14.3	11.1	19	4	3
Snack Foods (Excl. Nuts)	61.1	76.1	72.2	1.8	3.3	1.3	3	4	2
Breakfast Cereals & Pancake Mix	1.8	1.7	1.8	0.2	0.01	0.005	11	1	0
Red Meats, Fresh/Chilled/Frozen	13.0	6.5	4.8	0.7	0.03	0.07	5	0	1
Red Meats, Prepared/Preserved	2.9	5.1	3.9	0	0	0	0	0	0
Poultry Meat	65.7	31.2	26.2	53.6	7.1	4.4	82	23	17
Dairy Products (Excl. Cheese)	13.0	16.3	14.3	0.003	0.08	0.8	0	0	0
Cheese	3.0	3.6	2.8	0.006	0.004	0.001	0	0	0
Eggs & Products	5.7	10.1	8.7	0.5	0.5	0.1	9	5	6
Fresh Fruit	31.0	49.0	35.0	1.0	0.02	0.3	3	0	1
Fresh Vegetables	4.4	5.5	4.2	0.2	0.02	1.0	5	0	24
Processed Fruit & Vegetables	14.2	13.0	9.0	0.5	0.3	0.3	4	2	3
Fruit & Vegetable Juices	47.5	70.5	74.4	1.1	1.6	1.4	2	2	2
Tree Nuts	10.2	8.5	5.3	0.2	0.5	0.4	2	6	8
Wine & Beer	22.3	24.4	27.0	0.02	0.06	0.1	1	0	0
Nursery Products & Cut Flowers	7.4	10.2	10.3	0.02	0.04	0.008	0	0	0
Pet Foods (Dog & Cat Food)	22.2	30.0	26.3	0.6	0.7	0.9	3	2	3
Other Consumer-Oriented Products	731.0	679.0	932.0	41.0	42.0	16.0	6	6	2
FISH & SEAFOOD PRODUCTS	82.5	86.4	63.0	1.2	2.7	3.0	1.5	3.0	4.1
Salmon	2.8	2.5	2.6	0.04	0.01	0.4	1.4	0.4	15.4
Surimi	1.2	4.8	4.8	-	0.02	0.1	-	0.4	2.1
Crustaceans	0.9	1.5	1.6	0.05	0.04	0.03	5.5	2.7	1.9
Groundfish & Flatfish	7.3	4.1	5.7	0.05	0.3	0.3	0.7	7.3	5.3
Molluscs	1.1	1.7	1.0	0.05	0.08	0.06	4.5	4.7	6.0
Other Fishery Products	69.2	71.8	47.3	1.0	2.3	2.1	1.4	3.2	4.4
AGRICULTURAL PRODUCTS TOTAL	1056.0	1041.0	1259.0	102.0	56.0	26.6	10	5	4
AGRICULTURAL & FISH TOTAL	1138.5	1127.3	1321.5	103.0	59.0	29.6	9	5	2
AGRICULTURAL, FISH & FORESTRY TOTAL	1276.0	1142.0	1450.0	107.0	61.0	31.0	8	5	2

Source: State Statistic Committee of Ukraine

* Y 2003, January-September

TABLE C. TOP 15 SUPPLIERS OF CONSUMER FOODS AND EDIBLE FISHERY PRODUCTS

Ukraine Imports, \$ Million

*CONSUMER-ORIENTED AG TOTAL (\$MI)				FISH & SEAFOOD PRODUCTS (\$MI)			
Country	2001	2002	2003**	Country	2001	2002	2003**
Brazil	101.3	108.5	243.1	Norway	36.1	44.1	25.6
Russia	142.5	141.3	201.8	Estonia	17.9	16.1	10.8
Germany	66.3	84.7	73.1	Russia	15.4	6.3	3.7
Kazakhstan	17.3	2.3	61.4	United Kingdom	0.7	1.0	3.1
Poland	35.4	41.8	48.4	United States	1.8	2.7	3.0
Netherlands	52.1	58.8	48.2	Iceland	2.7	2.6	3.0
Cote d'Ivoire	19.6	35.7	42.7	Argentina	0.3	0.4	1.9
United States	112.9	68.1	34.7	Spain	0.5	0.6	1.3
France	32.7	32.6	33.7	China	0.6	0.9	1.1
China	10.7	17.3	29.4	Denmark	0.7	1.3	0.7
Norway	43.6	47.0	25.9	Canada	0.3	0.2	0.4
Hungary	16.7	18.8	23.9	Netherlands	0.4	0.4	0.4
Indonesia	24.9	54.6	23.3	Finland	0.3	0.4	0.4
Georgia	8.8	9.9	23.2	Poland	0.5	0.3	0.4
Turkey	38.0	41.4	22.9	Chile	0.1	0.4	0.4
Total by country	722.8	762.9	935.7	Total by country	78.3	77.7	56.2
Other	415.7	364.4	385.8	Other	4.2	8.7	6.8
World	1138.5	1127.3	1321.5	World	82.5	86.4	63.0

*HTS 1-24 groups

**January-September

Source: State Statistic Committee of Ukraine